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Jurisdictional Separations Reform and
Referral to the Federal-State Joint Board

CC Docket No. 80-286
DA No. 00-1865

**AT&T COMMENTS ON JOINT BOARD *RECOMMENDED DECISION*
ON JURISDICTIONAL SEPARATIONS**

Pursuant to the Commission's Public Notice, released August 15, 2000 (DA 00-1865), and Section 1.415 of the Commission's Rules, AT&T Corp. ("AT&T") submits these comments on the Joint Board's Recommended Decision on Separations Reform (FCC 00J-2), released July 21, 2000 ("*Recommended Decision*"), in this proceeding. The Joint Board recommends that "until such time as comprehensive reform of jurisdictional separations can be implemented," the Commission should "institute a five-year freeze of all Part 36 category relationships and allocation factors for price cap carriers, and a freeze of the allocation factors for rate-of-return carriers." *Recommended Decision* ¶¶ 1-2. According to the Joint Board, this so called "interim freeze will provide much needed simplification and stability to the separations process in a time of rapid market and technological changes." *Recommended Decision* ¶ 1.

AT&T strongly urges the Commission to *reject* the Joint Board's recommendation to institute an "interim" freeze. Almost three years ago, on October 7, 1997, the Commission initiated a rulemaking proceeding "with the goal of reviewing comprehensively [its] Part 36 jurisdictional separations procedures to ensure that they meet

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the objectives of the 1996 Act, and to consider changes that may need to be made to the jurisdictional separations process in light of changes in the law, technology, and market structure of the telecommunications industry."¹ Under that referral, the Joint Board has already had several years to consider and make substantive recommendations on comprehensive separations reform that would take into account technological changes and market structure evolution. Instead of performing this task and proposing substantive recommendations for separations reform, astonishingly, the Joint Board now suggests that the Commission should initiate a multiyear freeze which would have the effect of embedding into the separations process various pre-existing flaws that already result in the over-assignment of costs to the interstate jurisdiction. Moreover, such a freeze would prevent additional costs from being assigned to the intrastate jurisdiction as a result of rapid growth of Internet traffic which is treated as intrastate for separations purposes. For these reasons, the Commission should *reject* the Joint Board's recommendations.

In the absence of direction, these freezes tend to remain in place and become the *de facto* rule. As such, they tend to impede, rather than facilitate, true reform measures. Because the local exchange and exchange access markets are still not competitive and market forces are insufficient to control incumbent local exchange carrier ("LEC") pricing of regulated services, a jurisdictional separations process must remain in place to limit incumbents' ability to act on their incentives to over-allocate costs to either the state or federal jurisdictions, depending on current market conditions. A separations process is also

¹ Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Notice of Proposed Rulemaking, CC Docket No. 80-286, 12 FCC Rcd 22120, 22132, ¶ 2 (1997) ("*Notice*").

necessary to ensure the appropriate division of costs between the federal and state jurisdictions. Even under the price cap regime, separations remains relevant, for example, for the lower formula adjustment that continues as part of the CALLS Plan.² And, rate-of-return carriers' interstate revenue requirements are predicated on costs that the separations process assigns to the interstate jurisdiction. Although rate-of-return carriers are contemplating incentive regulation, their proposal also includes a lower formula adjustment.³ Simply freezing the Part 36 category relationships and allocation factors serves no legitimate purpose, and is inconsistent with the premise of the entire system – to assign costs to the appropriate regulatory jurisdiction.

The *Recommended Decision* advances two justifications in support of the proposed freeze. The first is to provide stability for carriers by minimizing costs shifts that might occur by circumstances not contemplated by the current Part 36 rules, such as the growth of Internet usage. The second is to reduce regulatory burdens on carriers during a transition from a regulated monopoly to a deregulated competitive environment in local markets. *Recommended Decision*, ¶ 15. Neither justification is valid.

The Joint Board's recommendation that if the FCC finds Internet traffic to be jurisdictionally interstate, then it should freeze the local dial equipment minute ("DEM")

² Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Federal State Joint Board on Universal Service, Low-Volume Long Distance Users, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket 99-249, Eleventh Report and Order in CC Docket No. 96-45, ¶ 181, released May 31, 2000 ("CALLS Order").

³ See Ex Parte Letter, dated February 28, 2000, from Lawrence E. Sarjeant, USTA, to Magalie Roman Salas, Secretary, FCC, CC Docket Nos. 98-77 and 96-45, Attachment: MAG Plan for Rate-of-Return Regulated Services.

factor at 95% of the current year level makes no sense. *Recommended Decision* ¶¶ 2, 11, 25, 29. Although Internet traffic is jurisdictionally interstate, this traffic is subject to the FCC's ISP exemption under which ISPs are permitted to purchase their telecommunications services from the LECs' local end user business tariffs in lieu of the LECs' interstate access tariffs. As a result, LECs' revenue recovery for ISP-bound traffic comes from charges assessed under *intrastate* tariffs. To avoid a mismatch between revenues and costs, the FCC has required – and should continue to require – the LECs to assign their Internet traffic-related costs to the intrastate jurisdiction.⁴ As the evidence cited by the Joint Board indicates, under the current rules, intrastate usage has consistently increased from 1996 to 1998 by large amounts. *Recommended Decision* ¶ 28 & n.65. Adoption of the proposed freeze would cause these

⁴ In its *Declaratory Ruling on Intercarrier Compensation for ISP-Bound Traffic*, the Commission specifically stated that "[w]ith respect to current arrangements, . . . this order does not alter the long-standing determination that ESPs (including ISPs), can procure their connections to LEC end offices under intrastate end-user tariffs, and thus for those LECs subject to jurisdictional separations both the costs and the revenues associated with such connections will continue to be accounted for as intrastate." *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic*, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, 14 FCC Rcd 3689, ¶ 36 (1999), *Declaratory Ruling vacated and remanded sub nom., Bell Atlantic Telephone Company v. FCC*, Nos. 99-1094, *et al.* (D.C. Cir. Mar. 24, 2000). See also "Common Carrier Bureau Issues Letter to SBC Regarding Its Jurisdictional Separations Treatment of Internet Traffic," Public Notice, 14 FCC Rcd 8178 (Com. Car. Bur. 1999) (directing SBC to reclassify traffic bound for ISPs as intrastate rather than interstate, for separations and reporting purposes); "Common Carrier Bureau Issues Letter to Bell Atlantic Regarding Jurisdictional Separations Treatment of Reciprocal Compensation for Internet Traffic," Public Notice, 14 FCC Rcd 13,148 (Com. Car. Bur. 1999) (directing Bell Atlantic to reclassify as intrastate reciprocal compensation amounts associated with traffic bound for ISPs).

costs to be shifted to interstate jurisdiction by reducing the local DEM factor and thereby allocating less costs to the intrastate jurisdiction.

The Joint Board's second purported justification appears to be simply an endorsement of LECs' assertions three years ago that the separations process is overly complex and cumbersome to administer.⁵ As Sprint explained, however, "the virtue of simplicity is highly overrated."⁶ The LECs have "automated" the process of complying with the separations rules, and therefore "the administrative burden of complying with the existing separations rules simply is not significant." *Id.* Thus, the benefits of any simplification proposal in terms of administrative efficiency would be slight.

The downside of the freeze proposal, however, would be substantial. First, the proposed freeze would cast in stone all of the existing misallocations of cost to the interstate jurisdiction.⁷ But even if those misallocations were corrected prior to freezing the separations factors, neither the Joint Board nor the LECs have offered any reason to assume that separations categorization and usage factors will continue to exhibit little change from year to year.⁸ The future is unknown, and if intrastate calling grows more quickly relative to

⁵ See Comments, filed December 10, 1997, in CC Docket No. 80-286 by USTA at 9 (separations process is "complex" and freezing allocations would be "administratively simpler" and would ease "regulatory compliance by incumbent LECs"); Bell Atlantic at 4; Ameritech at 9 ("significant savings due to easing of administrative requirements"); BellSouth at 10 ("simplification will greatly reduce the administrative burden and expense"); SBC at 7-12.

⁶ See Sprint Comments, filed December 10, 1997, at 8.

⁷ *Id.*; see also MCI Comments, filed December 10, 1997, at 5-6.

⁸ See NASUCA Comments, filed December 10, 1997, at 8.

interstate calling in the coming years (as is likely given the continued growth of the Internet), then freezing the separations factors would lock in an artificially high assignment of costs to the interstate jurisdiction. Frozen factors would almost guarantee an ever-growing inaccuracy in the jurisdictional separations allocations, as compared to continuing to recognize relative use factors, which reflect the current (and changing) nature of the LECs' operating environment. The use of frozen factors is not in the public interest and is certainly not justified by the LECs' make-weight concerns over administrative efficiency. Indeed, the Joint Board essentially concedes that a freeze will cause misallocations, by dismissing the IXCs' stated concerns as being "mitigated by the interim nature of the freeze." *Recommended Decision* ¶ 17. Suffice it to say that characterizing a five-year freeze as "interim" does nothing to alleviate AT&T's concerns. In short, the Commission should not elevate simplicity over all other concerns.

The only separations changes that are currently needed are those that AT&T had identified in its December 10, 1997 Comments in this proceeding. Specifically, the full embedded cost of unbundled network elements ("UNEs") and interconnection should be removed pre-separations because, under the scheme created by the 1996 Telecommunications Act, LECs will recover the full economic cost of interconnection and any unbundled element that an entrant leases. Moreover, if the costs associated with UNEs and interconnection are not pulled out pre-separations based on embedded cost, LECs could continue to overstate their access rates while pricing UNEs and interconnection at forward-looking cost. The solution is to treat UNE and interconnection costs analogous to the ways costs associated with deregulated services are treated and remove them from the cost base of regulated operations pre-separations.

Second, as AT&T showed, all "hidden" plant investment for the purpose of supporting services, such as LEC long distance services, should be removed from the regulated books and moved to the LECs' long distance operating affiliates. Enforcement of the principle that the LECs may only recover the cost of investment "used and useful" in providing regulated services has become all the more imperative today with the revelation that the Regional Bell Operating Companies ("RBOCs") cannot locate approximately \$5 billion of plant currently on their books.⁹

Third, as AT&T showed, significant amount of marketing and customer services expense are recovered from interstate carrier access, even though LECs do not actively market or advertise their exchange access services. Although this issue has been ameliorated for the price cap LECs as a result of the adoption of CALLS, it is still an existing problem with respect to rate-of-return carriers. Freezing the marketing-billed revenue factor, as recommended by the Joint Board, would inappropriately allow rate-of-return LECs to recover retail marketing costs from access customers. *Recommended Decision*, Appendix A. In addition, the current rules over allocate a significant amount of customer service expense to interstate carrier access. The proposed freezing of the IXC service order processing, IXC payment and collection, IXC billing inquiring allocation factors will continue this over allocation of customer service cost for at least five more years. *Id.* Removal of these costs from the interstate jurisdiction will promote efficient investment without preventing LECs from recovering all of their legitimate interstate costs.

⁹ See FCC News, FCC Releases Audit Reports on RBOCs' Property Records, Report No. CC 99-3, February 25, 1999.

CONCLUSION

For the reasons stated above, the Commission should *not* adopt an interim freeze and should undertake to reform the separations process in the limited manner discussed herein and in AT&T's December 10, 1997 Comments.

Respectfully submitted,

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September 25, 2000

CERTIFICATE OF SERVICE

I, Kelly Hannigan, do hereby certify that on this 25th day of September, 2000, a copy of the foregoing "AT&T Comments on Joint Board *Recommended Decision* on Jurisdictional Separations" was served via U.S. first class mail, postage prepaid, to the parties on the attached Service List.

/s/ Kelly Hannigan
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